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CHARLES ELMORE

No. 344

In the Supreme Court of the United States

OCTOBER TERM, 1929

CHARLES A. CORLISS, PETITIONER

v.

FRANK K. BOWERS, AS COLLECTOR OF INTERNAL REVENUE FOR THE SECOND DISTRICT OF NEW YORK

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR RESPONDENT

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OPINIONS BELOW

The opinion of the District Court (R. 22) is reported in 30 F. (2d) 135. The opinion of the Circuit Court of Appeals (R. 29) is reported in 34 F. (2d) 656.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on July 1, 1929. (R. 33.) Petition for certiorari to review the judgment was filed Au-

gust 27, 1929, and was granted October 21, 1929. (R. 34.) The jurisdiction of this Court rests on Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

The principal question is whether subdivisions (g) and (h) of Section 219 of the Revenue Act of 1924 are constitutional.

If so, the additional question is whether they are constitutional as applied to the income of a revocable trust created prior to the enactment of that Act.

STATUTE INVOLVED

The pertinent portions of the Revenue Act of 1924, c. 234, 43 Stat. 253, 277 (U. S. C., Title 26, Sec. 960), reads as follows:

> SEC. 219. * * *
>
> (g) Where the grantor of a trust has, at any time during the taxable year, either alone or in conjunction with any person not a beneficiary of the trust, the power to revest in himself title to any part of the corpus of the trust, then the income of such part of the trust for such taxable year shall be included in computing the net income of the grantor.
>
> (h) Where any part of the income of a trust may, in the discretion of the grantor of the trust, either alone or in conjunction with any person not a beneficiary of the trust, be distributed to the grantor or be held or accumulated for future distribution to him,

or where any part of the income of a trust is or may be applied to the payment of premiums upon policies of insurance on the life of the grantor (except policies of insurance irrevocably payable for the purposes and in the manner specified in paragraph (10) of subdivision (a) of Section 214), such part of the income of the trust shall be included in computing the net income of the grantor.

STATEMENT

On December 29, 1922, petitioner, in the County and State of New York, delivered a trust indenture to the trustee therein named, the Bankers Trust Company, of New York City, together with corporate stocks and securities listed in the schedule annexed to the indenture. (R. 3–4.) The trustee was directed to collect the income from the securities and pay it, after deducting commissions and expenses, to the petitioner's wife for the term of her life. (R. 9.) Upon her death the principal of the trust was to be paid in equal shares to the petitioner's children then living, and the issue of any deceased children, and in default thereof, to such persons as petitioner's wife might designate and appoint. (R. 9–10.)

By the second paragraph of the trust indenture petitioner reserved the right to instruct the trustee with respect to sales of the trust property and changes in the investment of the trust funds. (R. 10.) In the fifth paragraph the authority of the

trustee to deal with the stock and securities was set forth in detail and it was specified that in all these matters the trustee should act subject to the control and written directions of the petitioner. (R. 11–12.)

The seventh paragraph of the indenture provided as follows (R. 12–13):

> Notwithstanding anything to the contrary herein contained, the party of the first part may, from time to time, during the continuance of the trust, by instrument in writing executed and acknowledged in the manner required for a deed of real property so as to enable it to be recorded in the State of New York and delivered to the Trustee, modify or alter in any manner, or revoke in whole or in part, this indenture and the trusts then existing, and the estates and interests in property hereby created, and in case of such revocation said instrument shall direct the disposition to be made of the trust fund, or of the portion thereof affected by such revocation, and the Trustee shall make, execute and deliver such instruments, if any, and make such conveyances and transfers of property as may be necessary or proper in order to carry the same into effect, and no one shall have any right, interest or estate under this indenture except subject to the proper modification, alteration or revocation thereof.

The trust remained in this form in 1924 when $124,325.97, the net income for that year, was paid by the trustee to petitioner's wife. (R. 4.) In

petitioner's report of his income for that year, he made note of this trust and the amount of the income, but computed his tax without regard to such income. (R. 5–6.) He was later assessed $44,687.43, with interest, on the income from the trust property, which he paid under protest. (R. 6.) A claim for refund was thereafter filed and rejected (R. 7), whereupon this action was instituted. A motion to dismiss (R. 3) was granted (R. 2) and upon appeal the judgment was affirmed (R. 33–34). Petition for certiorari was not opposed.

SUMMARY OF ARGUMENT

Petitioner had power to revest in himself title to the corpus as well as the power to cause the income of the trust to be distributed to himself. Looking through the form of such a transaction, it appears that there has been little change in substance. Under the New York statute petitioner is still deemed to be the absolute owner of the estate conveyed so far as the rights of creditors and purchasers are concerned. This Court has held that the reservation of a power of revocation makes a transfer incomplete and it is not inconsistent with the rules of property to disregard for tax purposes the incomplete transfer and treat this transaction just as though the property still belonged to petitioner. There are many decisions to the effect that attempts to divide income from property before the tax attaches are ineffective for income-tax purposes. We submit that under those decisions and under the

doctrine of constructive receipt petitioner may constitutionally be held accountable for the income from the trust.

The contention that the application of the statute to income from a trust established prior to the enactment of the Revenue Act of 1924 renders it invalid finds no support in the decisions of this Court.

ARGUMENT

I

CONGRESS DID NOT EXCEED ITS POWER IN HOLDING THE GRANTOR ACCOUNTABLE FOR THE INCOME PRODUCED BY THE TRUST ESTATE HERE INVOLVED

This case does not present any question of statutory construction. The tax is plainly imposed by the explicit language of Section 219 (g) and (h) if that section is constitutional. It is clear and unambiguous and provides in effect that the grantor of a trust who has reserved the power to revest in himself title to the corpus, or who in his discretion may cause the income of the trust to be distributed or held for future distribution to himself, shall include the income of such trust in computing his own net income.

In the seventh paragraph of the trust here involved petitioner reserved the right from time to time during the continuance of the trust to "modify or alter in any manner, or revoke in whole or in part, this indenture and the trusts then existing." (R. 12–13.) Thus it is clear that petitioner had the

power to revest in himself the title to the corpus, as well as the power to cause the income of the trust to be distributed to himself. Accordingly, subdivisions (g) and (h) of Section 219 both apply. Petitioner's assertion (Brief, pp. 12–13) that his powers related only to the principal, and not to the income, is, we submit, without foundation.

This legislation looks through the form of the transaction and determines that in the case of revocable trusts there has been little change in substance. While the property was in form transferred by petitioner, and his wife received the income from the trustee, petitioner was in the same position as if he were making gifts from time to time of the income and without obligation to continue them. As said by the District Court in its opinion granting the motion to dismiss (R. 25):

> The New York Court of Appeals rightly characterized the income from a revocable trust as proceeding from his bounty and subject to his control, *Van Cott* v. *Prentice, supra,* pages 52–3.

Through the exercise of his power to modify, alter, or revoke the trust, petitioner at all times had the right either wholly to retake the corpus or to receive the income, which is "that which gives value to property." (*Pollock* v. *Farmers' Loan & Trust Co.,* 158 U. S. 601, 628.)

In the language of the District Court (R. 25):

> The trust property may of course by a proper instrument be sold by the settlor or

the income therefrom transferred before its accrual to a third person, such acts being implied assertions of his unqualified right to repossession. In the present case taxpayer expressly reserved unfettered power to sell and deal with the securities in the corpus of the trust; this would in any event have been possible by the exercise of his power of revocation. Income arising from property so completely subject to the settlor's needs and wishes may properly be taxed to him in order to effectuate the purposes of the surtax provisions. The pleader's conclusion that the creation of the trust herein involved was "bona fide" may be disregarded, for in so far as it means anything it means that the settlor had in view other purposes than reduction of his tax liability; this does not alter the fact that the purpose of the surtax provisions are set at naught by the revocable trust.

As the Circuit Court of Appeals expressed it (R. 32):

> A settlor of a revocable trust has a sufficient interest in the income of the trust and a relation thereto to justify the claim of a necessity for a fair and proper tax imposition requiring the settlor to pay. He, at all times, has the power to make the income derived from the trust, his own. To defeat tax evasion, at least the higher surtax, Congress, by this statute, has determined that a grantor who may change or modify the gift, even to putting an end to its continuance, must pay.

In this case it is not so important to determine what interest the beneficiary took under the trust; the real inquiry is, what interest did the petitioner retain? When it is considered that he reserved to himself the sole power of revocation, and the right at any time to revest in himself the corpus, and that even without revocation he could in his discretion elect to take the income, it is clear that the property which the petitioner conveyed to the trust is still his if he but reach out his hand and take it.

There is no authority in this Court which denies the power of Congress to tax the income of such a trust to the grantor thereof, and such decisions as there are on analogous questions tend strongly to sustain such power.

Petitioner's argument, based upon certain language in the opinion of this Court in *Eisner* v. *Macomber,* 252 U. S. 189, 206–207, can not be answered better than in the words of the District Court (R. 24):

> The *Macomber case,* however, is not authority for the proposition which plaintiff asserts. There Mr. Justice Pitney, says:
>
> "Here we have the essential matter: *Not* a gain *accruing* to capital, not a *growth* or *increment* of value *in* the investment; but a gain, a profit, something of exchangeable value *proceeding* from the property severed from the capital however invested or employed, and *coming in* being 'derived,' that is, *received* or *drawn by* the recipient (the taxpayer) for his *separate* use, benefit, and disposal; *that* is income derived from property."

> But the context and the italicization show that the emphasis was not at all upon that part of the sentence which would be relevant here. The decision merely holds that since the power given by the Sixteenth Amendment was to tax income, only income could be taxed; there was no occasion to decide and there was no decision as against whom the income could be taxed. Regardless of whether or not the Solicitor of the Treasury Department was properly influenced by *Eisner* v. *Macomber* in interpreting a doubtful statute, it is not a precedent on the present question of constitutionality.

Eisner v. *Macomber, supra,* is clearly not in point, and other decisions of this Court are more closely analogous to the present question.

This Court has already held that the reservation of a power of revocation makes a transfer incomplete. *Chase Nat. Bank* v. *United States,* 278 U. S. 327; *Reinecke* v. *Northern Trust Co.,* 278 U. S. 339. In *Chase Nat. Bank* v. *United States, supra,* it was said (p. 336):

> Such an outstanding power residing exclusively in a donor to recall a gift after it is made is a limitation on the gift which makes it incomplete as to the donor as well as to the donee * * *.

Applying that principle, it will be seen that up to the very moment when each individual payment of income was made to petitioner's wife the gift to her was incomplete; it was not beyond the control

of petitioner until she actually received it. Accordingly, putting aside the form of the transaction, each separate payment to petitioner's wife may be treated as a separate gift from him. If instead of allowing his wife to take the income petitioner had exercised his absolute right to take it himself, he would have been obliged to account for it as a part of his gross income, even though he immediately made a gift of the identical funds to his wife. We submit that petitioner could not, contrary to the express will of Congress, by first making an uncompleted gift of the income, deprive the Government of the right to tax it to him. We think that in substance it is not inconsistent with the rules of property to disregard for tax purposes the incomplete gift which has gone before and treat this transaction just as though the property still belonged to the petitioner and he had made the completed gift of the income to his wife after first receiving it himself.

In *Chase Nat. Bank* v. *United States, supra,* this Court disregarded the "vested" interest of the beneficiaries in certain insurance policies and held (p. 335) that the reserved interest of the decedent was "by no means the least substantial of the legal incidents of ownership" and regarded the transaction for estate tax purposes as a transfer at death of the *whole corpus.* In *Reinecke* v. *Northern Trust Co., supra,* the estate tax which was sustained was laid upon the *whole corpus* of the two revocable trusts, disregarding the fact that an interest had

been theretofore created through an uncompleted gift. This Court will not hesitate to sweep aside technical distinctions when they are raised to defeat the effective operation of a revenue measure. Thus, in *Chase Nat. Bank* v. *United States, supra,* it was held that the nonexercise of the power to change the beneficiary of a life-insurance policy was no less a transfer than would have been a transfer effected in other ways.

Also in *Taft* v. *Bowers,* 278 U. S. 470, it was held that Congress had power to require that for purposes of taxation the donee of a gift should accept the position of the donor in respect of the thing received, and the donee in that case was held subject to tax upon the sale of the property measured by the whole gain over the original cost to the donor.

Again, in *United States* v. *Robbins,* 269 U. S. 315, it was held that Congress had power to tax the husband upon the whole of the income from community property, in view of his power of disposition thereof, even if it were assumed that the wife also had an interest therein (p. 327).

The power of Congress to require a succeeding owner, in respect of taxation, to assume the place of his predecessor was pointed out in *United States* v. *Phellis,* 257 U. S. 156, 172.

In *Bullen* v. *Wisconsin,* 240 U. S. 625, 631, it was held that the Supreme Court of Wisconsin was "fully justified" in treating Bullen's general

power of disposition as equivalent to a fee for the purposes of the taxing statute and that there was no constitutional objection to its doing so. Petitioner's absolute and unconditional right to modify, alter or revoke the trust is treated, for tax purposes, as a general power to appoint (*Bullen* v. *Wisconsin, supra; Farmers' Loan & Trust Co.* v. *Bowers* (C. C. A. 2d), 29 F. (2d) 14, 18) and Congress was fully justified in treating his rights as equivalent to a fee and holding him accountable for the income which it produced.

In cases such as this, where the question is as to the power of Congress, local rules with respect to the subject matter of the tax are not of great importance. But here the New York law tends to support the view that the creation of a revocable trust makes no substantial change in the position of the grantor. The effect of a power of revocation under the local law applicable here was stated by the Circuit Court of Appeals as follows (R. 32):

> By Section 145 of the New York Real Property Law (where this indenture was made) when the grantor in the conveyance reserves to himself for his own benefit, a power of revocation, he is deemed the absolute owner of the estate conveyed so far as the rights of creditors and purchasers are concerned, illustrating how little the beneficiary obtains apart from the income.

Section 145 of the Real Property Law of New York is a part of the Consolidated Laws effective February 17, 1909. It reads as follows:

> Where the grantor in a conveyance reserves to himself for his own benefit, an absolute power of revocation, he is to be still deemed the absolute owner of the estate conveyed, so far as the rights of creditors and purchasers are concerned.

Both the District Court (R. 25) and the Circuit Court of Appeals (R. 32) regarded this statute as applying to personal property. With respect to the doubt expressed in petitioner's brief (p. 10) as to whether the earlier New York cases, which hold that it does relate to personalty (*Hutton* v. *Benkard*, 92 N. Y. 295; *Matter of Cooksey*, 182 N. Y. 92, 97; *Matter of Moehring*, 154 N. Y. 423, 427), are applicable since the adoption of the Consolidated Laws in 1909, we call attention to the opinion of Surrogate Fowler in 1912, in the case of *In re Mayo's Will*, 136 N. Y. S. 1066, 1068, where it was said:

> Powers connected with personal property are now for all practical purposes coextensive with powers in the law of real property of this state, and they are governed by the same rules. (Citing cases.)

In any case to which the statute is applicable the corpus of a trust estate created by revocable indenture is manifestly still valuable to the grantor in that it forms the basis of credit. But, in any event,

the statute does no more than express what is implicit in the idea of a complete power of revocation. Enjoying that right the grantor may use it for the benefit of his creditors, or may take the property and resell it, or may continue the trust to enjoy the income himself.

Of course the money was income and it was income from property which in a very real sense still belonged to the petitioner. There are many decisions to the effect that attempts to divide income from property before the tax attaches are ineffective for income tax purposes. See *Bing* v. *Bowers* (S. D. N. Y.), 22 F. (2d) 450; *Willard C. Hill* v. *Commissioner,* and *William H. Plumer* v. *Commissioner* (C. C. A. 1st), decided January 23, 1930, not yet reported; *Walter S. Benedict* v. *Warren G. Price* (E. D. N. Y.), decided November 26, 1929, not yet reported; *Rosenwald* v. *Commissioner* (C. C. A. 7th), 33 F. (2d) 423, certiorari denied, 280 U. S. 77A. In *Mitchel* v. *Bowers* (C. C. A. 2d), 15 F. (2d) 287, certiorari denied, 273 U. S. 759, the right to terminate a contract between a member of a partnership and his wife providing for the division of his share of partnership profits, so that the absolute disposition of the profits was always within the husband's power, was one of the grounds on which the court required him to account for his entire share. The Board of Tax Appeals has consistently applied the principle that where the taxpayer retains his interest in the property or fund

from which the income was derived, the income is taxable to him and not to the person who eventually receives the money. *J. V. Leydig v. Commissioner,* 15 B. T. A. 124, 132.

The presumption, of course, is in favor of the validity of an Act of Congress. This presumption, repeatedly indulged, is particularly strong when considering a Revenue Act. (*Nicol* v. *Ames,* 173 U. S. 509.)

Moreover, this statute has a special justification. It is clearly shown by the legislative history that the Act was designed to prevent avoidance of the surtaxes. See p. 21, House Report 179 on the Revenue Bill of 1924; p. 25, Senate Report 398 on the Internal Revenue Bill of 1924; 68th Congress, 1st Session, Serial Nos. 8226 and 8220. From the foundation of the Government taxes have been imposed in proportion to ability to bear the burden (*Knowlton* v. *Moore,* 178 U. S. 41, 98), and the principle of imposing taxes at higher rates on larger incomes has been sustained. (*Brushaber* v. *Union Pac. R. R.,* 240 U. S. 1; *Burk-Waggoner Assn.* v. *Hopkins,* 269 U. S. 110.) Therefore, a statute designed to protect the legislative policy of surtaxes should be treated no differently from a statute designed to prevent the complete avoidance of a tax.

We submit that Congress is not impotent to look through the form of a trust such as is here involved and require petitioner to treat the income there-

from as his own. In this case, as in the usual case of this sort, the beneficiary of the trust was one whom the grantor was bound to support and for whose benefit he would naturally have expended income in any event. We think that Congress might properly assume that trusts of this sort are commonly in lieu of other provisions for the support of dependents and that in reality the trust does not operate to decrease the grantor's income. A brief *amicus curiae* is on file which discusses the case of a revocable charitable trust. In such a case, it is true, the income is not received by some person for whom petitioner would normally make like provision from the same income if he took it himself. It will be time enough to consider the statute as applied to a charitable trust when such a case is presented (*United States* v. *Sullivan,* 274 U. S. 259, 264; *Yazoo & Mississippi Valley R. R.* v. *Jackson Vinegar Co.,* 226 U. S. 217, 219; *Old Colony Tr. Co.* v. *Comm'r. Int. Rev.,* 279 U. S. 716, 731), but it is submitted that no distinction as to the taxability to the grantor of the income of a revocable trust may validly be based on the character of the recipient of the income. It is the grantor's complete control and power to dispose for his own benefit of the corpus and income of the trust which is the basis of the tax. But in the case of a revocable charitable trust the grantor would be deemed to have given the income to the charity and such payments would be deductible from his gross income up to the permitted 15 per cent.

It is settled doctrine that Congress may require that property transferred to avoid a tax may be treated as part of the estate for the purposes of the estate tax (*Nichols* v. *Coolidge,* 274 U. S. 531, 542), and under that principle even a *completed* transfer may be disregarded. Accordingly, we think it is not open to substantial doubt that Congress may disregard a gift which was incomplete. At the moment when the beneficiary received the income, the gift was completed, and under the principle of constructive receipt which is recognized by a long line of decisions recently collected and approved by this Court in *Old Colony Tr. Co.* v. *Comm'r. Int. Rev.,* 279 U. S. 716, the income from property over which petitioner had at all times complete control may properly be treated as having been received by him and then paid over to the beneficiary.

We think it is clear from the foregoing that whatever other limitations may be imposed upon the taxing power of Congress, it has ample authority to require that an owner who has made but an uncompleted, because wholly revocable, gift of his property shall account for the income which it produces.

II

THE DECISIONS OF THIS COURT FORECLOSE THE CONTENTION THAT THE APPLICATION OF THE STATUTE TO INCOME FROM A TRUST ESTABLISHED PRIOR TO THE ENACTMENT OF THE REVENUE ACT OF 1924 RENDERS IT INVALID

Petitioner's argument based on the assumed retroactivity of the statute is wholly without merit. It is difficult to ascertain from the brief (pp. 25–26) whether petitioner's complaint is that it applies to a trust created prior to the passage of the Revenue Act of 1924, or that it applies to income derived prior to that date. Either objection is inadmissible.

In the first place, on the facts of this case there is, properly speaking, no question of retroactivity involved. As the Circuit Court of Appeals said (R. 33):

> The statute deals with the present condition with revocability residing in the settlor. Each payment of income which takes place after the passage of the statute is subject to its terms. Therefore, after the effective date of the taxing statute, this income was subject to taxation under its requirements. The taxing statute is not retroactive. (*Reinecke* vs. *Northern Trust Co., supra; Chase Natl. Bank* vs. *United States, supra; Saltonstall* vs. *Saltonstall,* 276 U. S. 260.)

Even if it were assumed that the application of the Act to a trust created in 1922 involved some element of retroactivity, it would by no means invalidate the statute.

The only decisions of this Court holding a taxing statute invalid because of retroactivity are *Nichols* v. *Coolidge,* 274 U. S. 531; *Blodgett* v. *Holden,* 275 U. S. 142 and *Untermyer* v. *Anderson,* 276 U. S. 440. In none of these cases was the objection to retroactivity as such, but it was based on the fact that the statute attempted to tax a past transaction which was made at a time when no tax thereon was foreseeable and which at the time that the taxing statute was enacted the grantor was powerless to undo. The imposition of an excise on such a transaction was held to be an arbitrary exaction, not within the taxing power. No such situation is presented here. The principles enunciated in those cases have no application to a transaction which is completely revocable by the grantor. He can undo the transaction at his will and make any new disposition of the property which the law permits, with full knowledge of the tax consequence. If it was really his desire to make provision for his wife, he may revoke the trust and create a new one without a power of revocation, and thus avoid from that time forward all liability for the tax upon the income thereof.

The only remaining objection is that certain instalments of income paid during the taxable year 1924, prior to the passage of the Revenue Act of 1924, may have become taxable to him without his foreseeing that consequence. As to such a suggestion the recent decision of this Court in *Cooper* v. *United States,* No. 93, October Term, 1929, decided

February 24, 1930, should be a complete answer. In that case the gift to the donee and the sale by the donee which resulted in the tax both were consummated before the enactment of the Revenue Act of 1921, under which the tax was collected. This Court held there was nothing unusual, arbitrary or capricious in the provision of the statute, and said:

> That the questioned provision cannot be declared in conflict with the Federal Constitution merely because it requires gains from prior but recent transactions to be treated as part of the taxpayer's gross income has not been open to serious doubt since *Brushaber* v. *Union Pacific R. R.*, 240 U. S. 1, and *Lynch* v. *Hornby*, 247 U. S. 339.

In the instant case the income which was the occasion for the tax was received during the year 1924, the taxable period provided by Section 200 of the statute. The Act was passed June 2, 1924, well within the taxable period, and it dealt with current events. Such limited retroactivity has been uniformly recognized as valid.

All of the Federal Income Tax Acts have been retroactive in the sense that they applied to income for a period which began prior to the passage of the several Acts. We submit that in so far as income taxes are concerned the practice in the past forecloses the contention that retroactivity brings an Act of Congress within the due process clause of the Fifth Amendment. This should be particularly true where, as here, the statute has a special

justification in the necessity for preventing tax avoidance.

The measure of the tax is income received during 1924, and the fact that the trust was established in a prior year is of no more consequence than it was in *Reinecke* v. *Northern Trust Co., supra,* or in *Saltonstall* v. *Saltonstall,* 276 U. S. 260. The receipt of income, the event which gave rise to the tax, occurred in 1924, and the validity of the application of the 1924 Act to such income is settled by the *Cooper case, supra.*

CONCLUSION

In view of the foregoing, it is respectfully submitted that the judgment of the court below is correct and should be affirmed.

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